This record is a partial extract of the original cable. The full text of the original cable is not available.

C O N F I D E N T I A L SECTION 01 OF 02 ANKARA 008986

SIPDIS

STATE FOR E, EB/CBED, EB/ESC, EUR/SE
STATE PASS NSC FOR QUANRUD AND BRYZA
USDOC FOR 4212/ITA/MAC/OEURA/CPD/DDEFALCO
USDOE FOR PUMPHREY/ROSSI

E.O. 12958: DECL: 12/12/2012
TAGS: ENRG ECON EPET AJ GG KZ TU
SUBJECT: BP STILL ANALYZING COMMERCIAL VIABILITY OF SHAH DENIZ

REF: (A) BAKU 2227 (B) ANKARA 7575

Classified by ADCM Scot Marciel, Reason 1.5 (b,d)

¶1. (C) Summary and comment: BP's gas analyst is struggling to make the commercial case for Shah Deniz -- although he claims top management is committed to the project, he believes the Turkish gas market is still oversupplied and the project is too expensive. He also maintains that transporting Caspian gas through Turkey to Europe is not economically viable. This current market review by BP may just be due diligence in the run-up to February sanction, or another negotiating tactic on the part of BP; however, given BP's November proposal to delay first gas to Turkey (ref a), and that its analyst is still crunching numbers in Turkey, it appears that BP's top management may still have some reservations about the project. End summary and comment.

¶2. (C) Brian Dodson (strictly protect), a gas analyst for BP, told econoff he is looking at the numbers from "every possible angle" to try to make Shah Deniz a more attractive project commercially for BP. Dodson said BP's top management "wants to do this project," that it made "strategic and political sense" given their other interests in the region; however, the numbers kept coming up wrong. Dodson stated there were real problems with Shah Deniz -- the Turkish market still looked oversupplied and there was no Turkish Treasury guarantee, the contract was not "robust," the cost of the project had soared to roughly USD 3 billion, and SOCAR had significant financing and government coordination problems. At this stage, he said, BP was proceeding with the project based on trust that these problems would be resolved, and USD 3 billion was a "lot of trust."

¶3. (C) Dodson conceded that, assuming the GOT purchased Shah Deniz gas according to the terms in the gas sales purchase agreement (SPA), BP would not lose money. But at the current profit margin, there were better places for BP to invest. Dodson noted that the Turkish gas market looked far better than it did six months ago, due to BOTAS' successful negotiations with Russia and Iran. Still, even after revising the supply figures, he estimated a gas surplus in Turkey from 2005-2011.

¶4. (C) Dodson noted that several factors could make the commercial equation more appealing. One was the gas transit tariff that the Energy Market Regulatory Authority (EMRA) sets. He noted that an entry/exit-based tariff would help make Caspian gas competitive in the Istanbul market as well as onward to Europe. (Note: BP has commissioned a study on the benefits of an entry/exit tariff, which we have provided to TDA consultants advising EMRA on the transit tariff. End note.) Another factor could be BOTAS further reducing its supply from Russia -- Dodson thought that Turkey might have some contractual flexibility in either the Russian West 1 or 2 sales purchase agreements that it had not yet divulged.

¶5. (C) Commenting on Turkey's desire to be a transit country for Caspian gas to Europe, Dodson said the numbers did not add up. Caspian gas would cost roughly USD 2/mmbtu at the Turkish border. If that gas was going to get to a European gas hub, he estimated an additional 1300 kilometers of pipeline needed to be built, at an approximate cost of USD 2 billion. Assuming the pipeline added an additional USD 0.60/mmbtu to the price of Shah Deniz gas, and that Turkey applied a very low transit tariff of USD 0.20/mmbtu, an optimistic estimate put Caspian gas at USD 2.80/mmbtu by the time it reached a hub in Europe. Since gas was currently trading at USD 2.30-2.50/mmbtu at European hubs, the math didn't work for Caspian gas. (Note: Dodson added that he was not an expert on the European gas market, and these were

his "napkin" calculations, adding that he would ask BP's European analysts to look into this issue.)

¶6. (C) Comment: Dodson's current market review may just be due diligence in the run-up to February sanction, or another negotiating tactic on the part of BP; however, given the concerns expressed by BP at the November partners' meeting (ref a), and that its analyst is still crunching numbers in Turkey, it appears that BP's top management may still have some reservations about Shah Deniz. Dodson was careful to emphasize that he was looking only at the numbers, while top management was considering Shah Deniz in a much broader context. (Note: BP execs told us previously that BP's top management agreed that Turkey had resolved its gas surplus problem (ref b).) As recently as last week, one BP exec told econoff the company was committed to Shah Deniz, while another said the company needed to "get its story straight" on gas. End comment.
PEARSON